

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on Chris Hani District Municipality

Report on the consolidated and separate financial statements

Introduction

1. I have audited the consolidated and separate financial statements of the Chris Hani District Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2015, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the consolidated and separate financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No.10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of

accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Receivables from exchange transactions

6. Sufficient appropriate audit evidence was not available to support receivables from exchange transactions. I was unable to confirm the amount by alternative means. In addition, I was unable to assess the estimates of allowance for impairment as the impairment was calculated on the take-on balances from the local municipalities on the transfer of the water and sanitation function and indigent debtors were not considered due to the absence of an indigent register. I was unable to confirm the amount by alternative means. Consequently, I am unable to determine whether any adjustments were necessary to receivables from exchange transactions and allowance for impairment amounting to R677,22 million and R341,46 million, respectively, as disclosed in note 12 to the consolidated and separate financial statements.
7. The municipality did not apply the approved impairment policy for the financial year under review. As a result, the allowance for impairment as disclosed in note 12 to the consolidated and separate financial statements and debt impairment expenditure as disclosed in note 28 to the consolidated and separate financial statements are understated by an amount of R29,26 million and receivables from exchange transactions are overstated by the same amount.
8. GRAP 104: *Financial instruments* require that an analysis by class of the age of financial assets that are past due but not impaired be recorded in the notes to the financial statements. The municipality did not make the necessary disclosure in note 12 to the consolidated and separate financial statements. Consequently, the financial statements have not been prepared in accordance with all the requirements of GRAP 104.

Revenue from exchange transactions

9. The municipality did not apply the correct tariffs as per the approved tariff policy and did not bill all consumers for water consumed during the financial year under review. As a result, service charges as disclosed in note 21 to the consolidated and separate financial statements are understated by an amount of R30,59 million and receivables from exchange transactions are overstated by the same amount.
10. Sufficient appropriate audit evidence was not available for service charges billed to consumers as disclosed in note 21 to the consolidated and separate financial statements. In addition, the municipality did not apply the approved indigent policy for the financial year under review. As a result, service charges revenue was billed but incorrectly included in revenue. I was unable to assess the extent of the revenue incorrectly included due to the absence of an indigent register. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to service charges amounting to R184,78 million as disclosed in note 21 to the consolidated and separate financial statements.

Aggregation of immaterial misstatements

11. The consolidated and separate financial statements are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the statement of financial position and the notes to the consolidated and separate financial statements:

- Property, plant and equipment are understated by R2,21 million.
- Receivables from non-exchange are understated by R4,67 million.
- Payables from exchange transactions are overstated by R1,76 million.
- Unspent conditional grants are overstated by R567 509.
- Net cash flows from operating activities and investing activities as disclosed in the statement of cash flow are overstated by R914 728.
- Irregular expenditure is understated by R28,02 million.

12. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm by alternative means, or determine whether adjustments were required to:

- Prepayments of R25,82 million as per note 8 as disclosed on the statement of financial position.
- Payables from exchange transactions of R11,10 million included in the disclosed balance of R138,72 million as per note 18 as disclosed on the statement of financial position.
- Receivables from non-exchange transactions of R12,42 million included in the disclosed balance of R16,97 million as per note 10 as disclosed in the statement of financial position.
- Bank overdraft transactions of R3,75 million included in the disclosed balance of R42,48 million as per note 13 as disclosed in the statement of position.
- Water losses of R17,02 million as per note 52 as disclosed in the notes to the consolidated and separate financial statements.
- The restated accumulated surplus balance at 1 July 2014 of R19,52 million as included in the disclosed balance of R3,55 billion as disclosed in the statement of changes in net assets.

Qualified opinion

13. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Chris Hani District Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

15. As disclosed in note 42 to the consolidated and separate financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during the year ended 30 June 2015 in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2014.

Unauthorised expenditure

16. As disclosed in note 46 to the consolidated and separate financial statements, unauthorised expenditure amounting to R215,13 million (2014: R25,62 million) was incurred by the municipality during the year. This was the result of the overspending of the total amount appropriated per vote for the Budget and Treasury Office in the municipalities approved budget.

Additional matter

17. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure note

18. In terms of section 125(2)(e) of the MFMA, the entity is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

19. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for the selected key performance area (KPA) presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

20. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for KPA 1: Basic Service Delivery and Infrastructure Development on pages x to x presented in the annual performance report of the municipality for the year ended 30 June 2015:
21. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

22. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
23. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
24. The material findings in respect of the selected KPA are as follows:

KPA 1: Basic service delivery and infrastructure development

Usefulness of reported performance information

Consistency of objectives

25. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Three (33%) of the reported development priorities were not consistent with those in the approved IDP. This was due to the limited review and monitoring of the completeness of reporting documents by management.

Measurability of indicators and targets

26. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 25% of the indicators and targets were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently.
27. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 41% of the targets were not specific in clearly identifying the nature and the required level of performance.

Reliability of reported performance information

28. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of standard operating procedures for the accurate recording of actual achievements and/or frequent review of the validity of reported achievements against source documentation.

Additional matter

29. I draw attention to the following matter:

Achievement of planned targets

30. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected KPA reported in paragraphs 25 to 28 of this report.

Compliance with legislation

31. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance

32. The performance management system and related controls were not maintained as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations (GNR 796 of 24 August 2001) (MPPMR).
33. The annual performance report for the year under review did not include measures taken to improve performance as required by section 46(1)(c) of the MSA.

Annual financial statements

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, expenditure and commitments identified by the auditors in the submitted financial statements were subsequently corrected but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

35. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
36. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Revenue management

37. A tariff policy was not implemented for the levying of fees for provision of municipal services, as required by section 74(1) of the MSA and section 62(1)(f)(i) of MFMA.
38. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.
39. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.

40. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
41. Accounts for service charges were not prepared, as required by section 64(2)(c) of the MFMA.
42. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

43. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

Performance audit committee

44. Sufficient appropriate audit evidence could not be submitted to substantiate that the performance audit committee did submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by regulation 14(4)(a)(iii) of the MPPMR.

Conditional grants and transfers

45. Municipal Infrastructure Grant funds were retained or rolled over to the next financial year without seeking the approval of the National Treasury, as required by section 22(1) of the DoRA.
46. Sufficient appropriate audit evidence could not be produced for auditing to substantiate that the municipality evaluates its performance in respect of programmes or functions funded by the Municipal Systems Improvement Grant and Municipal Infrastructure Grant allocation, as required by section 12(5) of the DoRA.

Consequence management

47. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
48. Allegations of financial misconduct laid against officials of the municipality were not investigated in accordance with the requirements of section 171(4)(a) and 172(3)(a) of the MFMA and Municipal regulations on financial misconduct procedures and criminal proceedings 5(1).

Procurement and contract management

49. Awards were made to providers who are in the service of other state institutions or whose directors are in the service of other state institutions, in contravention of section 112(j) of the MFMA and regulation 44 of the Supply chain management regulations (SCM). Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

50. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulations 17(a) and (c).
51. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).
52. Persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).
53. Sufficient appropriate audit evidence could not be obtained that the performance of contractors or providers was monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
54. Sufficient appropriate audit evidence could not be obtained that the contract performance and monitoring measures and methods were sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
55. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM Regulation 5.
56. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.

Internal control

57. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

58. There was insufficient oversight to ensure consistent implementation and monitoring of controls over financial, performance information and compliance with laws and regulations. This was mainly due to the fact that staff members did not fully understand the performance reporting and the leadership's slow responses to our recommendations on preparations and review of daily, weekly and monthly financial and performance information. The inadequate performance information reporting prevents the municipality from adequately monitoring the achievement of its objectives.
59. Consequence management was not implemented against officials who were responsible for incurring unauthorised, irregular and fruitless and wasteful expenditure as investigations were not done during the year under review.

Financial and performance management

60. The municipality did not have a proper system of records management for the financial environment as a whole as material misstatements were identified as well as an aggregation of numerous immaterial misstatements, resulting in a qualified audit opinion.
61. The maintenance of supporting information was deficient for performance reporting. There is a lack of information relating to the collection, collation, verification, storing and reporting of actual performance information and the setting of performance targets. This was due to the municipality not having approved standard operating procedures in place to ensure that all documentation is properly maintained for performance management and not preparing complete, accurate and reliable monthly and quarterly performance reports. As a result, the municipality did not identify errors timeously, resulting in material misstatements not being corrected.
62. The municipality did not have adequate systems in place to monitor compliance with all applicable legislation, as a result non-compliance with laws and regulations was not prevented. There is inadequate supervision, monitoring and consequence management in respect of the reporting process and, as a result, inadequate steps were taken to prevent and detect the incurrence of unauthorised, irregular, and fruitless and wasteful expenditure, and this promoted the culture of acceptability of non-compliance with laws and regulations.

Governance

63. The reporting provided by internal audit is not done timeously resulting in recommendations by internal audit not being implemented by management on time to address or reduce findings identified through the external audit process.
64. The fraud prevention plan was not reviewed and updated during the year under review and as a result controls were not designed and implemented timeously to mitigate risks that exist over financial, service delivery and compliance processes for the year under review.

Auditor-General

East London

18 December 2015



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence